ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Bowen	Analyst:	Kristina E. North	Bill Number:	SB 1736
Related Bills:	See Legislative History	Telephone:	845-6978	Introduced Date:	February 20, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Voluntary Contributions/Allow Any Qualified Organization, As Specified To Be Listed On The FTB Information Form To Receive Funds/Voluntary Income Tax Contributions Fund

SUMMARY

This bill would create a new process to allow taxpayers to make voluntary contribution designations on the personal income tax return.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to create a single process with set standards to allow taxpayers to designate voluntary contributions to charitable organizations on the personal income tax return.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2005.

POSITION

Pending.

Summary of Suggested Amendments

The author's office is working with Franchise Tax Board (FTB) staff to resolve the concerns addressed in this analysis.

ANALYSIS

FEDERAL/STATE LAW

Current federal tax law provides a true checkoff to direct $3 of a taxpayer's tax liability to the presidential election fund. Designation of the $3 amount does not affect a taxpayer's tax liability or refund amount.

Current state tax law allows taxpayers to make contributions of their own funds (not tax liability) on their tax returns to the eleven voluntary contribution funds listed on the state personal income tax return. Each fund is individually added to the tax return through the legislative process. The laws governing the contributions share the following requirements:

Board Position:			Department Director	Date
______ S	______ NA	______ NP		
______ SA	______ O	______ NAR	Gerald H. Goldberg	4/7/04
______ N	______ OUA	__X__ PENDING		

- once a designation is made it is irrevocable.
- the contribution amounts must be in full dollar amounts and may be made individually by each signatory on a joint return,
- if the payments and credits on a return do not exceed a taxpayer's liability, the return is treated as if no designation was made,
- if a taxpayer fails to specify a designee, the contribution is transferred to the General Fund after reimbursement for FTB's actual costs for collection and administration of contributions, and
- If a taxpayer designates more than one fund, but the amount available exceeds the total amount designated, the contribution is distributed among the designees on a pro rata basis.

Both repeal dates and the minimum contribution amounts, as adjusted, provide methods to review the effectiveness of the funds periodically and allow the removal of funds from the return. Although repeal dates and minimum contribution requirements generally apply to most of the current voluntary contribution funds, there are some differences among the funds. Please see the Attachment I for a comparison of the funds.

A maximum amount of number of voluntary contribution funds that may appear on the personal income tax return is not specified in statute. However, the Legislature recently started requesting queuing language for each proposed new voluntary contribution fund. The "queue" requires that an existing voluntary contribution fund must come off the personal income tax return before a new fund may be added. If more than one fund is chaptered in one year, or funds continue to be in the queue for subsequent years, each fund is added to the return based on the year and chaptering order, oldest first. Since the queue's inception, no voluntary contribution fund has been placed in the queue; all enacted funds have been added to the personal income tax return.

Each fund is generally required to reimburse FTB and the Controller for costs incurred in collecting or transferring the contribution amounts. Uncodified law (SB 702, Morgan, Stats. 1989, Ch. 954, Sections 10 and 11 of the bill) limits the amount of administrative costs for FTB to 3% in the first fiscal year, and 2% in each fiscal year thereafter for FTB and 2% in the first fiscal year, and 1% in each fiscal year thereafter for the Controller.

<u>THIS BILL</u>

This bill would repeal each existing voluntary contribution fund, the voluntary contribution general provisions, and legislative intent language pertaining to contribution process awareness.

This bill would create a new process to allow individual taxpayers to make voluntary contribution designations on their personal income tax return.

This bill would establish the Voluntary Income Tax Contributions Fund that would receive all contributions made by taxpayers to individual organizations listed on an information form accompanying tax return information. Taxpayers would be allowed to designate their own funds (not tax liability) for contribution to a qualified organization on their tax returns in full dollar amounts of $1 or more. Each signatory on a joint return may make the contributions individually. The designations for any taxable year must be made on the initial return for the taxable year and, once made, are irrevocable.

This bill would specify that if payments and credits reported on the return do not exceed the taxpayer's liability, then the taxpayer's return shall be treated as if no designation has been made. If no designee is specified, a designated contribution amount would be transferred to the General Fund. If a taxpayer designates a contribution to more than one qualified organization and the amount available for designation is not sufficient to satisfy the total amount designated, the contribution amount would be allocated among the designees on a pro rata basis.

This bill would require FTB to revise the personal income tax return to include a blank space or spaces for each permitted designation. Each designation would be listed on an information form.

This bill would require the Controller to transfer money as earmarked by FTB from taxpayer contribution designations from the Personal Income Tax Fund to the Voluntary Income Tax Contributions Fund. Upon appropriation by the Legislature, the money would be allocated to FTB and the Controller for reimbursement of administrative costs and to each organization receiving funds as earmarked by FTB.

To qualify to receive voluntary contributions, an organization would be required to:

- have received $1,000,000 in contributions and revenues in the prior taxable year,
- qualify as a charitable organization under the Internal Revenue Code (IRC),
- provide services to Californians that are consistent with the policies and programs of the state,
- gather an unspecified number of signatures from California voters that are verified by the Secretary of State,
- use voluntary taxpayer contributions to augment existing process or to provide new funding to related activities. Funds may not be used to meet the organization's administrative expenses,
- have no more than 50% of its annual revenue from voluntary taxpayer contributions established by this bill, and
- qualify to receive tax deductible charitable contributions under the IRC.

This bill would require organizations that qualify to submit an application to FTB no later than July 1 of each even-numbered calendar year. The application must contain the organization's name, the address of the principal place of business of the entity, and the name of the person, officer, or employee to whom the designated contributions would be remitted. If the name or person changes, the organization would be required to notify FTB. The organization also would be required to submit the names and personal addresses of the principals of the organization and the person who is a principal in the solicitation activities for the entity, as well as a financial report.

FTB could require the organization to file documents or information as needed to determine the use of funds.

FTB would be required to establish a fee to cover its cost to certify an organization for placement on the information form that must be paid by each organization that applies for placement on the information form.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is working with the author's office to resolve these and other concerns that may be identified.

- To accomplish the author's stated purpose for the bill, it may be necessary to preclude voluntary contribution funds from being added to the personal income tax return by individual legislation or any other manner is not provided.

- The 2004 tax booklets will be prepared for mailing at the end of the year for filing of the 2004 tax return in the 2005 calendar year. This bill specifies that applications may be received beginning July 1st, but does not specify if the new process would begin for the 2004 or 2005 tax year. Thus, FTB would need to consider its inclusion in the 2004 tax booklet. Without clarification, FTB would need to develop a process, determine a fee, submit a budget change proposal for any changes to the 2004 tax booklets to allow the department to comply with the provisions of this bill.

- Currently, ten bills introducing new voluntary contribution funds are in the legislative process. If any or all of these bills were enacted, these new voluntary contribution funds would appear on the 2004 personal income tax returns because this bill would eliminate only existing voluntary contributions.

- The meaning of the phrases "provides services to Californians," and "that are consistent with the policies and programs of the state," is unclear. As part of the qualification process, the absence of clarification of these phrases could lead to disputes with organizations and taxpayers, and would complicate the administration of this process.

- The bill specifies that qualifying organizations be listed "in the information form." FTB does not currently have an information form, however, it does have an information booklet. Current state law requires the department to create and design forms and publications that ease taxpayer compliance and minimize cost. No specific forms or publications are required, such as an "information form" specified in this bill. The author may wish to consider continuing to allow FTB to determine the form and manner in which this information is best provided, such as placing the qualifying organizations in the information booklet.

- FTB's area of expertise does not include certifying organizations for non-tax related criteria for a non-tax related purpose (i.e., the bill's requirement that a fund " provide services to Californians that are consistent with the policies and programs of the state"). The author may wish to assign the certification process to an agency that has such expertise. In the alternative, the author may wish to create a commission similar to the Oregon Charitable Checkoff Commission (See "Other States" for more information) as, according to the author's office, this bill is based on current Oregon law.

- This bill would create a new process and increase FTB's role in the governance of voluntary contribution funds. This could result in a moderate to significant impact to FTB's resources and the need for an appropriation to fund the process's setup and continuing administrative costs. There is no funding source identified in the bill for such costs.

- Depending upon the number of designations that appear on the return and the number of qualifying organizations, this bill could significantly increase the size of the tax return. For example, currently 80,000 charitable organizations exist that could potentially qualify for designation on the return. The author may wish to consider setting a limit on the number of designation spaces on the return and the maximum number of qualifying organizations that may be allowed.

- Currently, California lawmakers review voluntary contribution funds by setting a repeal date and an annually adjusted minimum contribution amount to remain on the tax return for designation. This bill would not require a method of periodic review, only that an organization submits a financial report to FTB. The author may wish to establish similar standards to ensure the viability of the contribution designation. Periodic review would allow the opportunity to review the effectiveness of the statutory process.

- This bill requires FTB to establish a fee to cover the costs of processing the application of an organization to appear on the information form. However, it is unclear if FTB should return the fee if the organization fails to meet the qualifications for listing. The author may wish to clarify the purpose and refundability of the fee.

TECHNICAL CONSIDERATIONS

The author requested the following technical amendments.

This bill creates one voluntary income tax contribution fund to receive all of the voluntary contribution designations. Amendment 1 would change the chapter name to "Voluntary Contribution Designations."

Referencing the Revenue and Taxation Code in addition to the IRC would be helpful in administering the provisions of this bill. Amendment 2 would change the reference.

This bill requires an organization to gather an unspecified number of signatures from California voters to qualify to receive voluntary contributions. Amendment 3 would remove that requirement.

Amendment 4 would change an incorrect reference.

PROGRAM BACKGROUND

Approximately 1% of California taxpayers have designated contributions to an average of one to five of the funds that have appeared on the return since 1982.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a voluntary contribution process comparable to the process proposed by this bill. *Illinois, Massachusetts, Michigan, Minnesota,* and *New York* allow for taxpayer contribution designations on the personal income tax returns via the legislative process. *Florida* does not have a personal income tax but allows contribution designations via the legislative process on the state's motor vehicle registration and renewal forms. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

Oregon has a seven-member commission, the Oregon Charitable Checkoff Commission, which determines the qualification of entities wishing to receive contribution designations via the tax process either by listing on the tax return, or listing in the Oregon Department of Revenue instructions. The Oregon Department of Revenue notifies the commission of the number of lines available for the inclusion of eligible entities, *without* adding a page to the various personal income tax forms. The commission limits the number of entries to be listed on the form. To remain listed in the instructions, the entity must meet the minimum contribution amount in at least one of the two preceding biennial tax years, and generally continue to meet the original qualifying criteria. The designations also have a six-year repeal date.

FISCAL IMPACT

Due to the implementation concerns above, the department's costs to administer this bill cannot be determined at this time. However, costs are anticipated to be moderate to significant, over $100,000.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

For each ten organizations that receive $250,000 each in voluntary contribution designations, and assuming that an itemized deduction is allowed and claimed for each contribution made to each organization, potential revenue losses would be on the order of $15,000 per organization, annually beginning with the taxable year the itemized deduction is claimed on the tax return (2006/2007 FY). The loss would be attributable to itemized deductions claimed for the contributions in the taxable year following the contributions.

Revenue Impact * ($ thousands)			
Fiscal Year	2004/2005	2005/2006	2006/2007
Revenue Loss	$0	-$150,000	-$150,000

*This estimate has been rounded.

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

<u>Revenue Discussion</u>

According to departmental data, the total amount of existing voluntary contributions to all funds under current law was nearly $4 million for fiscal year 2002/2003 with an average of $280,000 per individual designated fund.

Assuming contributions equal or exceed $250,000 and all contributors itemize deductions, the annual revenue loss would be on the order of $15,000 for each organization by applying an average marginal tax rate of 6% ($250,000 x 6% = $15,000).

LEGAL IMPACT

In *Kraft General Foods, Inc. v. Iowa Department of Revenue,* 505 US 71, 112 S. Ct. 2365 (1992), the United States Supreme Court held that states cannot discriminate against foreign dividends, even if the state is simply conforming to federal tax law. The court determined that, even if the federal government may discriminate in favor of domestic commerce, individual states cannot discriminate. The IRC currently allows a charitable deduction to domestic charities only, not foreign. California conforms to federal law in this area. However, by doing so, it may violate *Kraft*. For example, if a foreign organization otherwise meets the criteria for being listed as a voluntary contribution fund, except that it is not a United States charitable organization identified under IRC section 501(c)(3), a strong argument could be made under *Kraft* for its inclusion into the listing.

POLICY CONCERNS

The placement of designation for contribution lines on the tax return limits the amount of space available for tax-related items. The inclusion of non-tax related information could ultimately cause the tax form to become three or more pages, which is unprecedented among other states and the Internal Revenue Service. A three-page or more return also would cause the department to incur significant additional costs for printing, handling, and storage.

LEGISLATIVE STAFF CONTACT

Kristina E. North
Franchise Tax Board
845-6978
Kristina.North@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov

Analyst Kristina E. North
Telephone # 845-6978
Attorney Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1736
As Introduced February 20, 2004

AMENDMENT 1

On page 2, line 5, strikeout "VOLUNTARY FUNDS" and insert:

VOLUNTARY CONTRIBUTION DESIGNATIONS

AMENDMENT 2

On page 3, lines 3 and 4, strikeout "501(c)(3) organization as defined by the Internal Revenue Code." and insert:

charitable organization as defined by Section 23701d and 501(c)(3) of the Internal Revenue Code.

AMENDMENT 3

On page 3, strikeout lines 7 through 9, and redesignate remaining subdivisions appropriately.

AMENDMENT 4

On page 5, strikeout line 21, and insert:

Section 18707.